No. 17-494

In the Supreme Court of the United States

SOUTH DAKOTA,

Petitioner,

v.

WAYFAIR, INC., OVERSTOCK.COM, INC., AND NEWEGG, INC.,

Respondents.

On Writ of Certiorari to the Supreme Court of South Dakota

BRIEF FOR COLORADO AND 40 OTHER STATES, TWO UNITED STATES TERRITORIES, AND THE DISTRICT OF COLUMBIA AS AMICI CURIAE SUPPORTING PETITIONER

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QUESTION PRESENTED

Should this Court abrogate the physical-presence rule of *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), and *National Bellas Hess, Inc. v. Department of Revenue of Illinois*, 386 U.S. 753 (1967)?

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INTEREST OF *AMICI CURIAE*

Amici curiae are 41 States, two United States territories, and the District of Columbia—all jurisdictions that have a compelling interest in supporting South Dakota and seeing that the physical-presence rule is abrogated. As jurisdictions that rely on various forms of consumption taxes to fund their critical government operations, including sales and use taxes, the *amici* States seek to eliminate the artificial barriers that currently block the efficient and full collection of owed tax revenue or infringe their sovereign authority to enforce their tax laws. The physical-presence rule does both, to the States' detriment. The *amici* States thus strongly support abrogating the unprincipled physical-presence rule in favor of adhering to the Court's standard dormant Commerce Clause jurisprudence. *See Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977).

SUMMARY OF THE ARGUMENT

I.A. The physical-presence rule announced in *Bellas Hess* and reaffirmed in *Quill* has left the States in an increasingly untenable position. While the rule at the time of those decisions was largely confined to the mail-order catalog industry, today the thriving online retail industry claims the rule's protection to give itself a competitive advantage over brick-and-mortar retailers who must collect the owed tax. The net effect is that the *amici* States lose billions of dollars in tax revenue each year, requiring cuts to critical government programs. And as the pace of e-commerce continues to accelerate, the States' losses continue to compound at an ever-increasing rate. As Justice Kennedy put it, the physical-presence rule "now harms

States to a degree far greater than could have been anticipated earlier." *Direct Mktg. Ass'n v. Brohl* ("*DMA*"), 135 S. Ct. 1124, 1135 (2015) (Kennedy, J., concurring).

I.B. The *amici* States' dilemma is the product of an artificial rule that the Constitution never contemplated in the first place. The States have always been sovereign entities that hold the power to tax, enabling them to "raise their own revenues for the supply of their own wants." THE FEDERALIST NO. 32 (A. Hamilton). Exercising that power, the *amici* States long ago elected to impose a complementary sales and use tax scheme on retail transactions. This Court has repeatedly upheld the constitutionality of those taxes and recognized that interstate businesses are not immune from reasonable tax-related regulations. But the traditional physical-presence rule nonetheless persists. When it shields retailers, it infringes the States' sovereignty by stripping them of the most effective method of sales tax enforcement—direct collection by the retailer—but without doctrinal support under the Commerce Clause. Because it constitutes an unwarranted intrusion on the States' sovereignty, this Court should discard the outdated physical-presence rule and reaffirm the principle that the "modes" adopted by the States to enforce their taxes "should be interfered with as little as possible." *Dows v. City of Chicago*, 78 U.S. 108, 110 (1871).

I.C. Defenders of the physical-presence rule cite its supposed virtues—including certainty and reduced litigation. But those virtues have never been realized. Instead, the physical-presence rule has engendered extensive *Quill*-related litigation and created

widespread confusion over how the rule applies in today's modern e-commerce economy.

Nor does the possibility of retroactive tax liability constitute a valid reason for maintaining the physical-presence rule. South Dakota's law bans retroactive tax liability, eliminating that question as an issue in this case. Even if retroactive liability were a concern, existing regulations in many States will prevent retroactive application of a new post-*Quill* rule. Should other States choose to take a different approach, their normal procedures for implementing significant regulatory changes—including advance notice—provide adequate safeguards to abate any surprise that might accompany a new Supreme Court rule. And finally, if those safeguards do not resolve the question, this Court has the authority to craft a holding that applies prospectively only for all retailers and taxpayers.

I.D. Allowing the physical-presence rule to "wash away with the tides of time" is appropriate in light of the extraordinary advances in technology since *Bellas Hess* was decided in 1967. *Direct Mktg. Ass'n v. Brohl ("DMA II")*, 814 F.3d 1129, 1151 (10th Cir. 2016) (Gorsuch, J., concurring). Today's retailers are no longer laden with cumbersome hand calculations or hard-copy returns that must be mailed to far-away States. The Internet and modern software—the very same technology that allows online retailers to flourish in the first place—enables retailers to automatically generate the required tax returns and electronically file those returns with ease. In many States, the entire collection and remittance process can be outsourced, free of charge, to certified third-party service providers. And even if a retailer elects to keep the task in-house,

the *amici* States have provided numerous online tools and financial incentives to make the process as simple as possible. In short, the troublesome burdens that led the *Bellas Hess* majority to announce the physical-presence rule in the first place are no longer present in today's modern e-commerce economy.

ARGUMENT

I. *Quill*'s physical-presence rule should be abrogated.

The *amici* States agree with South Dakota that *Quill* should be abrogated. South Dakota's law comports with this Court's standard dormant Commerce Clause doctrine for the simple reason that *Quill* is an outlier that was wrongly decided in the first place, as the recent criticisms of the physical-presence rule by members of this Court illustrate. *See DMA*, 135 S. Ct. at 1135 (Kennedy, J., concurring) (stating *Quill* was "questionable even when decided"); *DMA II*, 814 F.3d at 1151 (Gorsuch, J., concurring) (observing *Quill* is "surrounded by a sea of contrary law"). This Court should therefore reverse the lower court's decision that *Quill* bars South Dakota's law, and provide guidance for other States that wish to enforce their own sales and use tax schemes against remote online retailers.

As for *Quill*, the *amici* States will not dwell here on the reasons why it was wrongly decided as a doctrinal matter—those arguments are fully presented elsewhere. Pet. Br. at 21–27. Instead, this brief will focus on the physical-presence rule's harmful effects on the *amici* States and why *stare decisis* offers no compelling justification to retain it.

A. *Quill* impairs the States' ability to deliver crucial government services.

Quill's physical-presence rule causes "a serious, continuing injustice" to the States in the form of a "startling revenue shortfall" that has no justification under the Constitution. *DMA*, 135 S. Ct. at 1134–35 (Kennedy, J., concurring). The revenue shortfall mentioned by Justice Kennedy hits the States where it hurts the most. As they have for decades, the *amici* States today rely heavily on sales and use tax revenue to fund their essential government operations. The States' education systems, healthcare services, and vital infrastructure projects, among others, all depend in large part on the States' ability to effectively collect the sales tax owed on the millions of retail transactions that occur daily across this country. *See id.*

From a tax administration perspective, the States' historical reliance on sales and use taxes for their crucial government functions made good sense.[1] When a retailer is required to collect the owed sales tax from the consumer at "check out," compliance approaches nearly 100 percent, perhaps the highest compliance rate of any tax. *See DMA II*, 814 F.3d at 1132 n.1. Compliance is made easy because of the sales tax's simplicity—consumers are relieved of any obligation to gather information or complete paperwork (as with the income tax), the tax is collected immediately when the

[1] Although equal in amount, the use tax differs slightly from the sales tax; it is typically owed by the consumer on the storage, use, or consumption of any article brought into the State when sales tax has not already been paid to the seller. *E.g.*, COLO. REV. STAT. § 39-26-202 (2017); *DMA*, 135 S. Ct. at 1127. Thus, when a remote online retailer does not collect the States' sales tax at "check out," the consumer continues to owe the use tax.

taxable event occurs (unlike the estate tax), and local governments need not send an annual bill (as with the property tax).[2]

Because of the efficiency of this arrangement, it comes as no surprise that 45 States and the District of Columbia have elected to enact a complementary sales and use tax scheme.[3] Nor is it surprising that sales tax revenue makes up a sizeable portion of the States' budgets. In South Dakota, it accounted for 61 percent of its 2016 general fund; in Tennessee, the figure is 60 percent; in Washington, nearly one half.[4] The States' ability to effectively collect this tax revenue is thus vital because, unlike the federal government, the States must balance their budgets each year.[5]

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[2] *See also* Gary S. Becker & Casey B. Mulligan, *Deadweight Costs and the Size of Government*, 46 J. L. & ECON. 293, 317 (2003) (explaining sales taxes are among the "most efficient taxes because they are relatively broad based and often have a flat rate structure").

[3] Jared Walczak & Scott Drenkard, *State and Local Sales Tax Rates in 2017*, Tax Foundation, p. 1 (Jan. 2017), https://tinyurl.com/zymow6g (last visited Feb. 14, 2018).

[4] S.D. Bureau of Finance & Mgmt., *Revenue Forecasts*, p. 1 (March 2015), https://tinyurl.com/yasyeot5 (last visited Feb. 14, 2018); State of Tennessee, *The Budget: Fiscal Year 2017-2018*, p. A-7 (Feb. 2016), https://tinyurl.com/yapb6tt9 (last visited Feb. 1, 2018); Wash. Economic & Revenue Forecast Council, *Washington State Economic and Revenue Forecast*, p. 50 (Sept. 2017), https://tinyurl.com/ya95n6m4 (last visited Feb. 14, 2018).

[5] Vermont is the only State without a legal requirement to balance its budget. National Conference of State Legislatures, *State Balanced Budget Requirements* (Apr. 12, 1999), https://tinyurl.com/ozphoqv (last visited Feb. 14, 2018).

But with the exponential growth of e-commerce, *Quill*'s outdated physical-presence rule throws a wrench into the States' tax machinery. Remote online retailers, claiming *Quill*'s protection, largely refuse to collect the sales tax at the point of sale, even though the consumer undisputedly owes the tax. Some remote online retailers even advertise—falsely—that their online sales are "tax free," Pet.App. 22a, thus compounding the problem by placing local, physically-present retailers at an apparent price disadvantage. *See DMA II*, 814 F.3d at 1150 (Gorsuch, J., concurring) (summarizing remote online retailers' argument that *Quill* entitles them to "a competitive advantage over brick-and-mortar competitors"). Local businesses and communities in turn suffer "concomitant unfairness" through *Quill*'s deleterious side effects—rental rates for retail space become depressed, brick-and-mortar merchants employ fewer local residents, and reduced economic activity erodes local tax bases. *DMA*, 135 S. Ct. at 1135 (Kennedy, J., concurring); *see also* Pet. 14–15.

Given remote online retailers' position, the confluence of the traditional physical-presence rule and the spike in e-commerce means the States' treasuries are losing sales tax revenue at alarming rates. A 2009 study places the States' combined tax losses from e-commerce sales at nearly $7 billion that year. Donald Bruce, et al., *State and Local Sales Tax Revenue Losses from e-Commerce*, 50 ST. TAX NOTES 537, 545 (2009) (Table 5). A study three years later is even starker,

estimating the States' combined losses at more than $23 billion in 2012.[6]

The pain felt by the States and their most vulnerable citizens is real, not theoretical. Alabama slashed $17 million from its state court budget in 2012; it lost $170 million on e-commerce transactions that year.[7] Colorado's largest school district cut $58 million from its budget in 2012; the State was owed more than $170 million on e-commerce transactions that year.[8] And New York eliminated $337 million from its Medicaid spending in 2012; according to the 2009 Bruce study, its estimated losses from e-commerce transactions in 2012 topped $865 million.[9] This is just a sampling of the extensive program cuts the States have been forced to endure. And as these examples show, the lost tax revenue from e-commerce transactions could readily help fill—or eliminate altogether—the States' burgeoning budget shortfalls in these important areas.

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[6] Hanns Kuttner, *Future Marketplace: Free and Fair*, Hudson Institute, p. 7 (May 2012), https://tinyurl.com/ybqauxoz (last visited Feb. 1, 2018).

[7] Brian Lawson, *Proposed cuts for Alabama courts 'crazy, devastating*, al.com, May 5, 2015, https://tinyurl.com/yacfe2p9 (last visited Feb. 5, 2018); Bruce, *supra*, at 545.

[8] *Lobato v. State*, 304 P.3d 1132, 1150 (Colo. 2013) (Bender, C.J., dissenting); *DMA*, 135 S. Ct. at 1135 (Kennedy, J., concurring); Bruce, *supra*, at 545.

[9] Erica Williams, et al., *State Budget Cuts in the New Fiscal Year are Unnecessarily Harmful*, Center on Budget and Policy Priorities, p. 19 (July 28, 2011), https://tinyurl.com/yby7jc7u (last visited Feb. 5, 2018); Bruce, *supra*, at 545.

As it has been for years, the trajectory of the States' tax losses is sharply upward, not down. Bruce, *supra*, at 545; *see DMA*, 135 S. Ct. at 1127 (noting e-commerce "more than tripled" between 2000 and 2010). By way of example, e-commerce sales in the third quarter of 2017 increased 15.5 percent over the previous year, while total retail sales increased just four percent.[10] The scope of the problem, and the resulting harm to the States, thus grows with each passing day.

Although the States have attempted to counteract these steep tax losses through a wide array of legislative and regulatory alternatives to direct collection by the retailer, none has proved an adequate substitute for direct collection itself.[11] When the States have attempted to coax remote online retailers into joining alternative solutions, either through voluntary or mandatory regulatory measures, the result has been disappointingly low tax collections or *Quill*-related legal challenges. Neither is surprising—remote online retailers understandably wish to protect what then-Judge Gorsuch described as a tax "arbitrage opportunity." *DMA II*, 814 F.3d at 1150 (Gorsuch, J., concurring).

The States' attempts to spur *consumers* into submitting their owed tax directly to the appropriate taxing agency have likewise proved unsuccessful. As

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[10] U.S. Census Bureau News, U.S. Dep't of Commerce, *Quarterly Retail E-Commerce Sales, 3rd Quarter 2017*, CB17-182, p. 1 (Nov. 17, 2017), https://tinyurl.com/nfcfkv8 (last visited Feb. 1, 2018).

[11] *See Br. for Colo. & 34 other States and the Dist. of Columbia as Amici Curiae Supporting Petitioner's Certiorari Petition*, pp. 7–11 ("*States' Cert. Br.*") (cataloging alternative collection measures the States have attempted without considerable success).

this Court and others have recognized, collecting the tax from the individual consumer after the taxable transaction has already transpired is "exceedingly difficult." *Overstock.com, Inc. v. N.Y. State Dep't of Taxation and Fin.*, 987 N.E.2d 621, 626 (N.Y. 2013); *see also DMA*, 135 S. Ct. at 1127 (recognizing voluntary consumer compliance with the use tax is "relatively low").

In most cases, the consumer fails to retain records of their many taxable-but-uncollected purchases, preventing them from accurately reporting the owed tax. *See* Lila Disque & Helen Hecht, *Beyond Quill and Congress: The Necessity of Sales Tax Enforcement and the Invention of a New Approach*, 65 AM. U. L. REV. 1163, 1180 (June 2016) (explaining "that most individuals do not regularly keep records of all purchases so that the tax owed can be verified"). Colorado's recently-upheld notice-and-reporting law, for example, contemplates that the consumer will submit his or her owed tax directly to the taxing authority, yet it is expected to close Colorado's growing "tax gap" by only 60 percent at most.[12]

Nor are audits of individual consumers practical. Creating the desired deterrent effect would require auditing a "significant percentage" of consumers. Disque & Hecht, 65 AM. U. L. REV. at 1180. But audits are one of the most expensive enforcement tools available, and unpaid sales and use taxes at the individual consumer level are relatively small amounts. Simply put, the low per-audit dollars at stake, coupled with the resource-intensive nature of audits, renders

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[12] Brief for Respondent at 9, *Direct Mktg. Ass'n v. Brohl*, 135 S. Ct. 1124 (No. 13-1032) (citing record).

consumer audits impractical. *See* William V. Vetter, *Preying on the Web: Tax Collection in the Virtual World*, 28 FLA. ST. U. L. REV. 649, 751 (2001) ("Auditing all of the individuals in a state to determine if they owed use taxes would, obviously, be a losing proposition."). Importantly, while that means that small sellers and individual consumers bear little audit risk, it also means that the States need other practical solutions.

These logistical challenges, combined with *Quill*'s physical-presence rule, have yielded a dismal use tax compliance rate. In 2000, the United States General Accounting Office estimated that compliance with the States' use tax laws hovers between zero and five percent.[13] Nothing indicates it has improved since then. To the contrary, in his *DMA* concurrence three years ago, Justice Kennedy pegged California's compliance rate at just four percent. 135 S. Ct. at 1135. These statistics are consistent with the *amici* States' overall experience. At bottom, collection of the tax directly from the consumer is not practical and does not result in meaningful tax revenue that might otherwise substitute for direct collection by remote online retailers.

Accordingly, because remote online retailers' invocation of the traditional physical-presence rule causes sizeable and rising tax losses to the States, resulting in critical program cuts, this Court should

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[13] U.S. General Accounting Office, *Sales Taxes: Electronic Commerce Growth Presents Challenges; Revenue Losses Are Uncertain*, p. 35 (June 2000), https://tinyurl.com/y6uk7fzf (last visited Feb. 14, 2018).

abrogate *Quill* and hold that it presents no bar to South Dakota's law.

B. The physical-presence rule unlawfully infringes on the States' sovereignty.

Beyond *Quill*'s significant financial impact on the States, there is a more fundamental problem. The traditional physical-presence rule violates the States' sovereignty. This Court has long upheld the constitutionality of the States' complementary sales and use tax schemes. *See Henneford v. Silas Mason Co.*, 300 U.S. 577, 584 (1937). But the traditional physical-presence rule prevents the States from fully implementing and enforcing these tax laws that have been on the books for decades and upheld by this Court. *See Int'l Harvester Co. v. Wis. Dep't of Taxation*, 322 U.S. 435, 444 (1944) (recognizing that a "practically effective device [is] necessary in order to enable the state to collect its tax"). The rule thus violates the bedrock principle of State sovereignty underlying our federal system.

The historical record recognizes the "justness" of the States "possess[ing] an independent and uncontrollable authority to raise their own revenues for the supply of their own wants." THE FEDERALIST NO. 32 (A. Hamilton). This State taxing power exists, Alexander Hamilton said, because the States "clearly retain all the rights of sovereignty which they had before" and which were not delegated to the federal government's exclusive authority. *Id.* "An attempt on the part of the national government to abridge them in the exercise of [their taxing power] would be a violent assumption of power, unwarranted by any article or clause of its Constitution." *Id.* Put another way, "preventing the

collection of a tax laid by the authority of the State ... would not be the supreme law of the land, but a usurpation of power not granted by the Constitution." THE FEDERALIST NO. 33 (A. Hamilton).

This Court, too, has affirmed the States' sovereign taxing power. As far back as *M'Culloch v. State of Maryland*, 17 U.S. 316, 429 (1819), the Court recognized that "[a]ll subjects over which the sovereign power of a state extends, are objects of taxation." *Accord City of Detroit v. The Murray Corp.*, 355 U.S. 489, 495 (1958) (citing *M'Culloch* and upholding Michigan tax on airplane subcontractor doing business under contract with the federal government). Underpinning this uncontroversial holding is the corollary principle that "the modes adopted [by the States] to enforce the taxes levied should be interfered with as little as possible." *Dows*, 78 U.S. at 110. Such interference with the States' modes of taxation risks "derang[ing] the operations of government," causing "serious detriment to the public." *Id.*

Yet this danger is precisely what *Quill*'s traditional physical-presence rule visits upon the States. Not only does the rule exact an ever-increasing toll on the States' budgets and social safety-net programs, it paralyzes the States' ability to respond effectively to the economic and societal problems within their borders. By taking off the table the most productive form of sales tax collection, *Quill*'s traditional physical-presence rule forces the States to cast about for different, workable alternatives. But as the *amici* States have already shown, those alternatives have been extensively tested and shown to be inadequate. *States' Cert. Br.*, pp. 7–11. Even if an alternative were

viable, the mere act of removing the straightforward direct-collection option from the States' slate of choices still constitutes an unwarranted infringement on the States' sovereignty.

While the *amici* States do not question Congress' ability to affirmatively regulate tax collection practices to the extent they impact interstate commerce, to date Congress has chosen not to wade into this area. *See id.* at 23. And "[u]nder our federal system, the determination [regarding the wisdom of a tax] is to be made by state legislatures in the *first instance* and, if necessary, by Congress . . . ." *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 628 (1981) (emphasis added). Against this backdrop, the traditional taxing authority of the States provides an unusually strong justification to not over-read the Commerce Clause to strip the States of a sovereign power in the absence of Congressional action.

Accordingly, this Court should abrogate *Quill*'s traditional physical-presence rule to prevent further encroachment on the States' taxing sovereignty.

C. *Quill*'s purported virtues do not merit keeping its broken physical-presence rule.

Those who support *Quill*'s physical-presence rule emphasize that the benefits supposedly offered by the rule—certainty and reduced litigation—outweigh the deep financial harm to the States and the intrusion on their sovereignty. They also suggest that overturning *Quill* will lead to unfair surprise by imposing retroactive tax liability on unsuspecting retailers. BIO at 34–36. But *Quill*'s purported benefits and the concerns over retroactivity were questionable the day

that *Quill* was announced. *See Quill*, 504 U.S. at 329–30 (White, J., concurring in part and dissenting in part) (predicting that it is "very doubtful" that the majority's goal of reducing litigation will be accomplished); *id.* at 332 (stating "such [retroactivity] fears are groundless because no one can sensibly insist on automatic retroactivity for any and all judicial decisions in the federal system." (internal quotations omitted)). Even starting from a low bar, such concerns have grown far weaker with the passage of time.

Quill-related litigation and confusion. History teaches that *Quill*, far from reducing confusion and litigation, has actually led to the opposite. When the States attempt to implement alternative *Quill*-compliant collection measures to shore up their treasuries, they are met with expensive and time-consuming *Quill*-related litigation. *See States' Cert. Br.*, pp. 18–20.

In Colorado, the State spent seven years litigating whether *Quill* barred its consumer-notification-and-reporting law. *Id.* at 17–18. The lower courts were understandably puzzled, unsure whether and to what extent *Quill* might bar Colorado's attempt to impose obligations that are similar to, but distinct from, those that *Quill* rendered off limits. After three appellate reversals involving two different preliminary injunctions in both state and federal court, the Tenth Circuit finally provided the last word: the "exceptional narrowness" of *Quill*'s "ratio decidendi" is rooted in *stare decisis* only, and thus does not bar the States from enacting "other comparable regulatory and tax duties[.]" *DMA II*, 814 F.3d at 1149, 1151 (Gorsuch, J., concurring).

Similarly, New York spent five years defending its "click-through nexus" law against a *Quill* challenge from Overstock.com, a respondent in this case. *See Overstock.com, Inc.*, 987 N.E.2d 621. There, the courts wrestled with whether the physical-presence rule protected an out-of-state retailer that advertised through an in-state affiliate's website—a situation never contemplated by either the *Quill* or *Bellas Hess* majorities. *Id.* at 625–27. So too in Massachusetts. It was recently sued over its regulation that recognizes nexus over large Internet vendors that have certain elements of e-commerce technology present in Massachusetts. *See States' Cert. Br.*, p. 12 n.16. That case remains ongoing.

In these cases, and many others like them, *Quill*-related litigation has led to confusion over the States' ability to implement alternative solutions. The lengthy string of litigation shows that *Quill*'s supposed "bright line" is no longer bright due to changed economic markets and improved technology. As Justice Kennedy has recognized, in today's modern Internet age, "a business may be present in a State in a meaningful way without that presence being physical in the traditional sense of the term." *DMA*, 135 S. Ct. at 1135 (Kennedy, J., concurring). But *Quill*'s antiquated rule, designed for a pre-Internet economy, does not take account of these "far-reaching systemic and structural changes" caused by the Internet. *Id.* It has thus led to widespread uncertainty over how the rule should be applied in today's modern e-commerce market.

Beyond protracted litigation, the confusion caused by *Quill* has also hindered State taxing authorities' ability to administer and enforce their sales and use

taxes. State lawmakers are left with no principled method for predicting whether their attempted legislative strategies for mitigating the *Quill* problem will pass constitutional muster. State Attorneys General are hampered in their ability to counsel their government clients, not knowing the contours of *Quill*'s reach in today's modern Internet age. In turn, State tax agencies and rulemaking bodies must fashion rules and provide guidance knowing that their efforts will be challenged in court as violating a rule meant to address the marketplace as it existed a half-century ago.

This cycle of uncertainty will no doubt continue if the traditional physical-presence rule is retained. Facing increasing revenue shortfalls, State and local governments will have little choice but to continue experimenting with alternative—and suboptimal—methods for collecting the owed tax. As they do so, the degree of uncertainty for retailers and consumers will continue to grow as the concept of physical presence becomes an increasingly less useful proxy for in-state economic activity. Does offering a virtual "trunk club" subscription service, where a retailer ships customers monthly packages of designer clothes, constitute physical presence?[14] What if the remote online retailer provides a courier return service?[15] What about an online engineering company that provides global website security services and enhanced content delivery through its network of data centers that are

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[14] Stitch Fix, Inc., https://www.stitchfix.com (last visited Feb. 22, 2018).

[15] Casper Sleep, Inc., *Tell Me More About the 100 Night Trial*, https://tinyurl.com/y6tvlofp (last visited Feb. 22, 2018).

scattered across multiple (but not all) States?[16] The traditional physical-presence rule does not answer these complex questions posed by today's Internet-based marketplace.

By any reasonable measure, the traditional physical-presence rule—first announced in 1967, two years before the moon landing—has proved unworkable in today's interconnected market. Absent this Court abrogating the rule, *Quill*-related litigation and confusion will continue to proliferate, costing the States, retailers, and ultimately the public, millions in litigation expenses and lost resources.

Retroactive tax liability. Defenders of the physical-presence rule often cite the possibility of retroactive tax liability if *Quill* is abrogated. BIO at 34–36. That concern was also present in *Quill*, and the *amici* States acknowledge that this Court has said imposing retroactive tax liability can raise "thorny questions." *Quill*, 504 U.S. at 318 n.10.

But those questions are not presented in this case. By its terms, South Dakota's law is prospective in operation only; imposing retroactive tax liability is prohibited and an injunction bars enforcement of the law while the instant case remains pending. Pet. Br. at 2a–3a. Because of these features of South Dakota's law, any holding by this Court abrogating *Quill* will not apply retroactive tax liability on Respondents. Their tax liability, if any, will be on a prospective basis only. South Dakota's law thus removes the retroactive-tax-liability issue from this case.

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[16] Cloudflare, Inc., *Step 1: How Does Cloudflare Work?* (Feb. 11, 2018), https://tinyurl.com/j59oh2b (last visited March 1, 2018).

Even if certain States, implementing a holding by this Court abrogating the physical-presence rule, chose to apply their laws retroactively, other legal and pragmatic safeguards will address any constitutional concerns. Pet. Br. at 48–49. For one, many States have regulations or other administrative guidance in place that bar imposing collection obligations on remote retailers that currently fall within *Quill*'s ambit.[17] Pet. Br. at 7a–8a. This guidance would limit retroactive enforcement of a new "post-*Quill*" rule announced by this Court.

For another, as tax collectors and administrators, the *amici* States have incentives to ensure that large-scale regulatory changes are implemented carefully and fairly. After all, "[t]he procedures for mass assessment and collection of state taxes ... are generally complex and necessarily designed to operate according to established rules." *Perez v. Ledesma*, 401 U.S. 82, 127 n.17 (1971) (Brennan, J., concurring in part and dissenting in part). For this reason alone, the *amici* States generally provide, as a matter of course, advance notice of significant regulatory changes, announcing both the nature of the change and its effective date.[18]

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[17] *See, e.g.*, IOWA ADMIN. CODE r. 701-107.8(423B) (2018); MO. CODE REGS. ANN. tit. 12, § 10-114-100 (2017); Colo. Dep't of Revenue, *FYI Sales 5: Sales Tax Information for Out-of-State Businesses* (Apr. 2013), https://tinyurl.com/y746jwa9 (last visited Feb. 14, 2018).

[18] *See, e.g.*, Colo. Dep't of Revenue, *FYI General 10: Consumer Use Tax* (July 2017) (advising Internet retailers of the effective date for enforcement of Colorado's notice-and-reporting law), https://tinyurl.com/y87c7pfd (last visited Feb. 13, 2018).

If South Dakota prevails here, there is no reason to suspect that the *amici* States will deviate from their normal administrative procedures—including advance notice—when implementing this Court's new post-*Quill* precedent.[19] While there is no one formula that all States must follow, providing this type of notice benefits the States by giving them time to prepare intake procedures, increasing taxpayers' compliance, and satisfying potential State and federal due process requirements. *See Harper v. Va. Dep't of Taxation*, 509 U.S. 86, 100 (1993) (indicating the States "retain[] flexibility" under the Due Process clause when responding to a determination that a tax unlawfully discriminates).

In the unlikely event that a future retailer believes this Court's decision abrogating *Quill* is being retroactively applied to them in an impermissible manner under either federal or State law, the States' customary procedures for resolving tax disputes, and the right to judicial review, will provide the retailer with an appropriate opportunity to be heard. *Cf. id.* at 101–02 (stating Virginia is "free to choose which form of relief it will provide, so long as that relief satisfies the minimum federal [due process] requirements we have outlined." (internal quotations omitted)). The States are well equipped to structure their tax laws to both comply with due process and avoid unconstitutional retrospective applications of new rules. *Cf. United States v. Carlton*, 512 U.S. 26, 30–31 (1994) (stating the legislature may structure its tax laws to have retroactive effect if "supported by a

[19] This is not to suggest that the *amici* States will forgo conventional enforcement proceedings against those retailers who *improperly* rely on *Quill*'s protection.

legitimate legislative purpose furthered by rational means . . . ." (internal quotations omitted)).

If, after consideration of the foregoing, the Court remains concerned about retroactivity issues in abrogating *Quill*, the Court of course retains flexibility to fashion a holding that operates prospectively only, thus avoiding the surprise that may accompany retroactive application of a new rule. *See Chevron Oil Co. v. Huson*, 404 U.S. 97, 106–07 (1971). Although this Court's precedent since *Chevron Oil* now disfavors "selective temporal barriers" to full retroactive application of a new rule, *Harper*, 509 U.S. at 97, the absence of prior-period liability in this unique case leaves open the option of a "prospective only" rule. *See id.* (quoting *James B. Beam Distilling Co. v. Georgia*, 501 U.S. 529, 539 (1991) (opinion of Souter, J.,)) (stating an opinion "announcing a rule of federal law 'is properly understood to have ... retroactive application'" *unless* the Court "'reserve[s] the question whether its holding should be applied to the parties before it'").[20]

Accordingly, because the purported virtues of the physical-presence rule do not outweigh its harms, this Court should rule in South Dakota's favor.

D. The burdens of collection that prompted the physical-presence rule have drastically faded.

In *DMA*, Justice Kennedy called for *Quill*'s physical-presence rule to be abrogated unless "a powerful

[20] A number of lower federal courts have concluded that *Harper* did not overrule *Chevron Oil*'s three-part test for determining whether a new rule should be applied prospectively only. *See Nunez-Reyes v. Holder*, 646 F.3d 684, 691–92 (9th Cir. 2011) (collecting cases).

showing can be made that its rationale is still correct." 135 S. Ct. at 1135 (Kennedy, J., concurring). *Quill*'s rationale was based not on its own constitutional force, but instead on *stare decisis* and the precedential value of *Bellas Hess*. That decision, in turn, was based on the marketplace as it existed in 1967, and the Court's view that burdening the mail-order catalog industry with the duty to collect might stunt the industry's growth. *See Bellas Hess*, 386 U.S. at 759–60. Because business models and technology have dramatically changed since *Bellas Hess*, and because the burdens of collecting have been all but eliminated, this Court should not hesitate to give the physical-presence rule the "complete burial it justly deserves." *Quill*, 504 U.S. at 321 (White, J., concurring in part and dissenting in part).

In 1967, when *Bellas Hess* was decided, the process for an out-of-state retailer to collect and remit another State's sales tax was perhaps daunting. Retailers were forced to manually look up the current tax rate by State and city—a task that was "not only time consuming, tedious, and expensive," but "also prone to error." Ray Westphal, *The Computer's Role in Simplifying Compliance with State and Local Taxation*, 39 VAND. L. REV. 1097, 1099 (1986). When *Quill* was decided 25 years later, however, the majority did not dispute the dissent's observation that "modern computer and software technology" had significantly reduced the burden of collection. *Quill*, 504 U.S. at 332 (White, J., concurring in part and dissenting in part).

Today, with the Internet's near-ubiquitous use by retailers, the burden of collection (if any) has become miniscule. The days of manual calculations and mailing

hard-copy returns at the Post Office are gone. Retailers today are generally able to file their returns electronically over the Internet without ever leaving the comfort of their home or workplace.[21] In many cases, including in the 24 States that are members of the Streamlined Sales and Use Tax Agreement ("SSUTA"), a uniform electronic return format eases compliance even more.[22] In fact, the entire collection and remittance process under SSUTA can be accomplished through certified third-party service providers that are paid for by the member States and made available to retailers at no charge.[23] The availability of these service providers and electronic filing methods removes any conceivable burden that collection obligations might otherwise impose on retailers.

Other States that have not or cannot join SSUTA similarly eliminate or reduce the financial burdens of collection. For example, a majority of States compensate collecting retailers by allowing them to retain both a small portion of the tax collected—sometimes called a vendor discount—and the "net float" income that is earned from investing the tax

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[21] California, for example, has implemented an electronic registration system for retailers to register with the State and pay their use taxes online. https://tinyurl.com/y9fc3ndc (last visited March 2, 2018); *see also* 1 COLO. CODE REGS. § 201-1:39-21-120(3) (2018) (discussing Colorado's electronic data interchange method for filing tax returns).

[22] *See Br. for Amicus Curiae Streamlined Sales Tax Governing Board, Inc. Supporting Petitioner's Certiorari Petition*, p. 11 ("*Streamlined Cert. Br.*").

[23] *Streamlined Cert. Br.*, p. 12–13.

funds prior to periodic remittance to the State.[24] Retailers are permitted to keep both components of this compensation even if their collection costs are zero or negligible, and even though this Court has said that interstate business "must pay its way." *W. Live Stock v. Bureau of Revenue*, 303 U.S. 250, 254 (1938) ("[T]he bare fact that one is carrying on interstate commerce does not relieve him from many forms of state taxation which add to the cost of his business." (internal citations omitted)).

The financial burden of compliance is also made easy on the backend for those retailers that discover they may have inadvertently failed to accurately collect and remit the tax. Thirty-eight States and the District of Columbia participate in the Multistate Voluntary Disclosure Program.[25] The program allows retailers with potential tax liabilities in multiple States to negotiate a penalty-free settlement through the Multistate Tax Commission. By negotiating a single settlement through the Commission that satisfies all obligations in the participating States, the program offers retailers a faster, more efficient, and less costly resolution than approaching each State separately.

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[24] *E.g.*, COLO. REV. STAT. § 39-26-105(1)(c)(II)(A) (2017); Federation of Tax Administrators, *State Sales Tax Rates and Vendor Discounts* (Jan. 2018), https://tinyurl.com/ybvbw25r (last visited Feb. 13, 2018); PricewaterhouseCoopers LLP, *Retail Sales Tax Compliance Costs: A National Estimate*, p. 9 (Apr. 7, 2006), https://tinyurl com/j32k2xt (last visited Feb. 13, 2018).

[25] Multistate Tax Commission, *Multistate Voluntary Disclosure Program: Overview of Multistate Voluntary Disclosure Process*, https://tinyurl.com/y9jpug5f (last visited Feb. 14, 2018).

Several States go even further by eliminating not only the financial burden of collection, but also the logistical burdens retailers may experience. Some States, for example, provide certified address databases that retailers can utilize to look up the tax rate where the consumer resides.[26] Assuming the retailer uses the certified database, they are held harmless for any resulting tax or other liability that may arise from errors in the database. Certain States also provide lists of sales tax software that retailers may use to automatically create an electronic return that may then be uploaded to the taxing agency; Colorado, for example, has ten approved vendors that provide e-file software and services at minimal cost.[27] If those do not work, retailers remain free to search out their own solutions on the open market; "end-to-end" sales tax compliance solutions can be obtained for as low as $50 per year for small businesses.[28]

Of course, the sophisticated online retailers whose sales generate the bulk of the States' tax losses do not need such software or service providers. Their advanced online platforms boast impressive technology that enables them to not only comply (easily) with State collection laws, but also capture extensive data about their customers. According to one commentator, an online retailer can effortlessly track demographic

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[26] *E.g.*, COLO. REV. STAT. §§ 39-26-105.3 & 204.5 (2017); SSUTA § 331.

[27] *See* Colo. Dep't of Revenue, *Sales Tax Efile: Approved Colorado Sales Tax Efile Vendors* (July 19, 2016), https://tinyurl.com/yd55qzc8 (last visited Feb. 13, 2018).

[28] Avalara, Inc., *AvaTax Pricing*, https://tinyurl.com/yaf6wk9r (last visited Feb. 20, 2018).

information that includes "'your age, whether you are married and have kids, which part of town you live in, how long it takes you to drive to the store, your estimated salary, whether you've moved recently, what credit cards you carry in your wallet and what Web sites you visit ... data about your ethnicity, job history, the magazines you read, if you've ever declared bankruptcy or got divorced, the year you bought (or lost) your house, where you went to college, what kinds of topics you talk about online, whether you prefer certain brands of coffee, paper towels, cereal or applesauce, your political leanings, reading habits, charitable giving and the number of cars you own.'"[29]

The very technology that makes online retailers so successful at targeting their customers also allows them to collect and remit the owed sales tax through an automated process that requires minimal effort.[30] This is evident in this very case—one of the four retailers that South Dakota sued, Systemax, agreed to voluntary comply rather than assert a *Quill* defense; it began collecting South Dakota's sales tax the very next day. Pet. 30. Because they can readily "flip a switch" to begin collecting, today's online retailers are, to say the least, in a far superior position compared to their 1967

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[29] Helen Hecht & Lila Disque, *DMA v. Brohl—Is it Time to Stop Fighting the Last War?*, 26-JUL J. Multistate Tax'n 14, 46 (2016) (quoting Charles Duhigg, How Companies Learn Your Secrets, The New York Times Magazine, Feb. 16, 2012).

[30] *See* Waltreese Carroll, *Can Technology Lessen the Tax Burdens on Interstate Commerce*, 2012 ST. TAX TODAY 143-2 (2012) (quoting Charles Collins, Vice President of Governmental Affairs at Automatic Data Processing, Inc.—a certified service provider under the SSUTA—as stating that "technology has moved in a direction that has alleviated the burdens at issue in *Quill*").

predecessors whose logistical challenges prompted the physical-presence rule in the first place.

Accordingly, because the burdens of collection have largely disappeared since the time of *Bellas Hess* and *Quill*, this Court should abrogate the physical-presence rule.

CONCLUSION

For the foregoing reasons, the decision of the South Dakota Supreme Court should be reversed.

Respectfully submitted,

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